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[APPELLATE CIVIL JURISDICTION]

McELWAINE, C.J., MILLS AND HORNE, J.

March 3, 1939.

In the Matter of the Estate Duty Ordinance, Section 36

and

In the Matter of the Estate of Wynfreda Jeannie Dunbar Hogg, deceased.

J. S. ANDERSON

vs.

THE COMMISSIONER OF ESTATE DUTIES

(SINGAPORE CIVIL APPEAL No. 5 of 1938)

Estate Duty—Private Limited Company—Valuation of Shares Subject to Restrictions on Transfer—Construction of Articles of Association.

Mrs. H. died possessed of 833 "A" shares in the "S" company. At the date of her death the "S" company was a private limited company with a capital of $1,000,000/- divided into 5,000 Ordinary shares of $100/- each and 500 "A" shares of $100/- each. The "A" shares carried (a) the right to participate in a distribution of profits up to but not exceeding 15 per cent in respect of any year, if declared, after paying or providing for the payment of a dividend for such year on the Ordinary shares at the rate of 15 per cent but did not carry any further right to participate in profits except to such extent (if any) as the Company in General Meeting might resolve; and (b) the right in a winding up to the whole of the surplus assets of the Company available for distribution amongst its members which would remain after repaying the whole of the capital paid up on the ordinary shares. The Ordinary shares carried no rights to participate in surplus assets in a winding up beyond the full amount paid up on each Ordinary share. The transfer of shares was restricted by the Articles. Voting control of the "S" Company was in the "U" Company. The "S" Company had substantial reserves, and the rights of the "A" shares to surplus assets in a winding up would have made the "A" shares very valuable had a winding up been commenced or in prospect. There was, however, no prospect of a winding up and the deceased's holding was insufficient to enable her, or her representative, to force a winding up.

The "A" shares had never received dividends of more than 5% per annum. The executor of the deceased valued the deceased's "A" shares at par ($100/-) or thereabouts. The Commissioner of Estate Duties valued the deceased's "A" shares at $959/- each, i.e. on the basis of a hypothetical winding up assumed to take place at the date of the death. Against this valuation the executor petitioned the Court. The Petition was heard by Terrell J. who held that the shares should not be valued as on the basis of a hypothetical winding up but valued the "A" shares at $375/- each. Against this valuation the executor appealed to the Court of Appeal. There was no cross-appeal.

Held, (1) that the value of the shares for the purpose of Estate Duty was to be estimated at the price which they would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered and to be regarded as the holder of the shares, and should take and hold them subject to the provisions of the Articles of Association, including those relating to the alienation and transfer of shares in the Company.

(2) That restrictions on the right to transfer or alienate shares is a depreciating factor. How much it depreciates the value of the shares depends upon the rigidity and extent of the restriction imposed by the Articles of Association governing the particular shares.

(3) **per McElwaine C.J. and Horne J.** that upon the true construction of the Special Resolutions and Articles of Association and having regard to all other matters affecting the "A" shares, the value to be placed upon them under section 15 (1) of the Estate Duty Ordinance was $150/- each.

(4) **per Mills J.** that the value to be placed upon the "A" shares under section 15 (1) was $100/- each. The Court has no jurisdiction to say what reserve fund may be "properly" required by a company. What portion of the profits should be retained is entirely a matter of internal management which the shareholders must decide for themselves, and the Court has no jurisdiction to control or review their decision.

Commissioners of Inland Revenue v. Crossman (1937) A.C. 26; **Attorney General v. Jameson** (1905) 2 I.R. 218; **Smyth v. Revenue Commissioners** (1931) 2 I.R. 643; **Burland v. Earle** (1902) A.C. at p. 95 followed and applied.

K. K. O'Connor for the Appellant.

The shares must be valued under S. 15(1) of the Estate Duty Ordinance, and the criterion is "what would a hypothetical purchaser pay to stand in the shoes of the deceased owner of the shares with good title to get into them and remain in them, and to receive all the profits subject to all the liabilities of the position". *Attorney General v. Jameson* (1905) 2 I.R. 218; *Borland's Trustee v. Steel Bros. & Co.*, (1901) 1 Ch. D. 279, 288.

The Court will assume that the hypothetical purchaser can get registered, even where in fact, owing to restrictions on transfer, he could not. But that is the only assumption the Court may make. Having got upon the company's register, the hypothetical purchaser would then be bound by the restrictions on transfer when he wished to transfer in his turn. That would make the shares a frozen asset in his hands, would greatly affect their marketability, and hence would affect the price the hypothetical purchaser would give for them in the first instance. Restrictions on transfer are a depreciating incident. *(Attorney General v. Jameson supra; Commissioners of Inland Revenue v. Crossman* 1937 A.C. 26;). The amount of depreciation depends on the stringency of the restrictions on transfer but restrictions on transfer may reduce the market value of a share by as much as 50 per cent. See Mr. Philip's

evidence in this case and *Commissioners I.R. v. Crossman supra; Smyth v. Revenue Commissioners* (1931) I.R. 643). There is no substantial difference between the restrictions in the *Crossman* case and this case. The learned Judge below, in valuing the shares at $375/- each, did not give any, or sufficient, weight to the restrictions on transfer affecting the shares in the hands of a purchaser.

Further, the learned Judge treated the "A" shares as having a right to a dividend of 15% per annum and valued them accordingly: whereas, under Special Resolution No. 3, the dividend right of the "A" shares was merely to participate in a distribution of profits *up to but not exceeding 15 per cent in respect of any year, if declared,* after paying or providing for the payment of a dividend on the Ordinary shares at the rate of 15%, but no further right to participate in profits except to such extent (if any) as the Company in general meeting might from time to time resolve. Control of the company was in the hands of the "U" company, the shareholder who held almost all the Ordinary shares, and payment of a dividend to the "A" shareholders was subject to the controlling shareholder's sanction. It would be against the interest of the controlling shareholder to give large dividends to the "A" shareholders. The prospect of a dividend in excess of 15% is negligible. The "A" shares have never had more than 5% per annum, and there is no evidence or ground for believing that that the rate will be increased. If it be said that the rate of dividend will shortly be increased to 15% per annum because the reserves are now sufficient to cover the company's contingent liabilities as shown in the balance sheet, I say there is no evidence what reserves the directors consider sufficient for the company's purposes. They may be building up reserves to finance expansion. The reserves have been more than sufficient to cover the company's balance sheet liabilities for some years, yet the rate of dividend on the "A" shares has not been increased. There is no knowing when, if ever, it will be increased.

The "A" shares on dividend record are worth about par and no more. The Crown sought to inflate that value, arguing that, under Article 99 A.(2), the "A" shareholders would be entitled to a distribution of the very substantial reserves *pari passu* with the Ordinary shareholders. But this is not so. A bonus distribution under Article 99 A.(2) would *prima facie* go to the same persons as are entitled to dividends, that is to say to the Ordinary shareholders, subject to paying the "A" shareholders sufficient to bring their dividend up to 15% in the year of distribution. At the very most, the "A" shareholders could not be entitled to more than $35/- (or $42/-) per "A" share in a distribution, being the amount by which their dividends have fallen short of 15% per annum since their creation. This would be to treat them as cumulative shares with a right to 15% per annum, which they are not.

Also, as found by the learned Judge, there is nothing to prevent the controlling shareholder from distributing the reserves to the Ordinary shareholder *in specie* under Article 99 A.(1), after providing 15% for the "A" shareholders in that year.

Accordingly the alleged right of the "A" shareholders to participate *pari passu* with the Ordinary shares in a distribution of the reserves is illusory. The market value of the "A" shares cannot be substantially appreciated for this.

The Court will not interfere with the decision of majority shareholders unless there is fraud or they are acting *ultra vires*. The majority cannot be forced to distribute reserves as dividends, and the Court has no jurisdiction to control or review their decision or to say what is a "fair" or "reasonable" sum to remain undivided. *Burland v. Earle* 1902 A.C. 83 (P.C.); *Dominion Cotton Mills v. Amyot* 1912 A.C. 547; *Will v. United Lankat Co., Ltd.,* 1914 A.C. 11 (1912) 2 Ch. 571, 580; *re William Metcalfe* (1933) 1 Ch. D. 142, 161. *Menier v. Hooper's Telegraph Works* 9 Ch. App. 350 is distinguishable. That was a case of fraud. *Birch v. Cropper* 14 A.C. 525, 536 cited in the Court below is also clearly distinguishable.

We suggest that the learned Judge was wrong in construing Special Resolution No. 3 as excluding the Ordinary shareholders from participating rateably with the "A" shareholders in any further distribution of profits after the first 15% until the "A" shareholders had received 15%. The Ordinary shares were in existence before the "A" shares, and were entitled to participate rateably throughout, except to the extent that a rateable participation was negatived by the Special Resolution creating the "A" shares *re Fraser & Chalmers* (1919) 2 Ch. 114, 120. There is nothing in Special Resolution No. 3 to negative rateable distribution after the first 15% has gone to the Ordinary shareholders and until the "A" shareholders have had 15%. The ordinary, grammatical meaning of "participate" is "to take part in". The "A" shares participate in a residue after the Ordinary shares have had 15%. This is not a "narrow" or "forced" construction of the word "participate" as stated by the learned Judge. The

fact that the company has not acted on this interpretation is not conclusive against it. But, however this may be, the "A" shareholders are not entitled to more than 15%, they have never had more than 5%, and there is nothing to show when, if ever, that rate of distribution would be increased. Existing circumstances must be regarded *Christie v. Lord Advocate* (1936) A.C. 569.

The rights attached to the "A" shares could be varied without the consent of the purchaser of the 833 "A" shares, (*Palmer.* Company Law 15th edn. p. 84), and the possibility of such a variation in the future is a depreciating factor which a purchaser would take into account.

The learned Judge took into consideration as an appreciating incident the right to purchase the shares of other members at a fair value as fixed by the Company's auditors. Having regard to the way in which other members shares were settled and held, this right was illusory. There would have been no shares to purchase.

Crossman's case and *Smyth's* case *supra* show that a purchaser of shares subject to restrictions on transfer such as exist in this case would require to see a 10% to 12% yield on his money. The "A" shares have a history of 5% and a prospect of up to 15% depending on the controlling shareholder. If you take it that there is a fair prospect of a future yield of 10% per annum, that would make the "A" shares, on the basis of *Smyth's* and *Crossman's* cases, worth about $100/- each.

N. A. Worley Solicitor General for the Respondent.

Having considered O'Connor's argument and *Bouch v. Sproule* (1887) 12 A.C. 385, I now abandon the contention that the "A" shareholders would have a right to a *pari passu* distribution under Article 99 A(2). The most they could expect would be 35% or 42½% on their capital. I also concede that the Company could, as found by the learned Judge, at any moment distribute the whole of the surplus assets by way of dividend to the Ordinary shareholders either in cash or *in specie,* subject to the payment of the full 15% in that particular year to the "A" shareholders; but it is very unlikely that such a distribution would be made.

Under Article 99 A.(2) the company cannot distribute in excess of the amount recommended by the directors. The directors are trustees for the company and must treat the two classes of shareholders fairly. *Hailsham* Vol. V pp. 314, 315; *Kelly v. Maori Dream Gold Mines Ltd.* (1898) 14 T.L.R. 402.

The correct interpretation of Special Resolution No. 3 is that the "A" shareholders must get 15% alone after the Ordinary shareholders have had 15%. You may not look outside the resolution, and this precludes you from looking at what the position was before the contract was entered into. If it was intended to preserve existing rights there should have been express words in the Special Resolution to that effect.

The company's liabilities have been provided for and there is no apparent reason for accumulating further surplus assets. The learned Judge was right in finding that a prospective purchaser could reasonably expect to get a dividend of not less than 15% per annum in future.

As to a possible variation of rights of the "A" shareholders a purchaser of the deceased's shares would assume that other "A" shareholders would join to resist this.

Nothing need be deducted for restrictions on transfer.

O'Connor in reply.

McElwaine, C.J.—Wynfreda Jeannie Dunbar Hogg (hereinafter referred to as Mrs. Hogg) died on 15th November 1936 possessed among other property of 833 "A" shares in Singapore and General Investment Company Ltd. (hereinafter referred to as the Company) and these shares passed on her death.

The Commissioner of Estate Duties assessed these shares for Estate Duty purposes at $959 per share (based on a hypothetical winding up) and against this assessment the appellant, who is one of the executors of the estate of Mrs. Hogg petitioned the Court. The petition was heard by Terrell J. who reduced the Commissioner's assessment and valued the shares at $375 each.

The appellant appeals against the reduced valuation arrived at by Terrell J. alleging that the shares are worth much less than $375 each. No cross appeal has been brought.

The Company is a private company and was established with a capital of $500,000 composed of 5000 shares of $100/- each of which 4997 were issued. These shares I refer to as Ordinary Shares.

In July 1933 at an Extraordinary General Meeting of the members of the Company special resolutions

were passed altering the Articles of Association and increasing the capital of the Company to $1,000,000/- by the creation of 5000 new shares of $100/- each to be called "A" shares.

Another company United Investments Malaya Ltd. held 4995 of the 4997 issued Ordinary Shares and 1668 of the "A" shares and therefore held a controlling interest in the Company.

The Articles of Association of the Company prohibit the transfer of shares to non-members save under certain prescribed conditions.

Although many cases were cited there was no dispute as to the legal principle upon which the shares were to be valued. The whole difficulty of the case lies in the application of the principle.

Section 15(1) of the Estate Duty Ordinance enacts that the principal value of any property shall be estimated to be the price which such property would fetch if sold in the open market at the time of the death of the deceased.

The application of the corresponding provision of the English Finance Act 1894 to shares the alienation of which was restricted, fell to be considered in *Commissioners of Inland Revenue v. Crossman* (1937) A.C. 26 when the majority of the House of Lords, approving the judgment of the Irish Court of Appeal in *Attorney-General v. Jameson* (1905) 2 Ir. R. 218, decided that the value of the shares for the purpose of Estate Duty was to be estimated at the price which they would fetch if sold in the open market on the terms that the purchaser should be entitled to be registered and to be regarded as the holder of the shares, and should take and hold them subject to the provisions of the Articles of Association, including those relating to the alienation and transfer of shares in the Company.

In applying this principle it is necessary to consider several factors—the par value of the shares, the rate of interest that has been paid upon them, the rights conferred upon the shareholders (including their voting powers), the liabilities of the shareholders and the disabilities imposed on shareholders who desire to sell or part with their shares by the articles of the Company.

Restriction on the right to transfer or alienate shares is a depreciating factor. How much it depreciates depends upon the rigidity and extent of the restriction imposed by the Articles of Association governing the particular shares.

The Articles governing the rights of shareholders to transfer or alienate their shares so far as material are:

"Article 17(1) A share may be transferred by a member or other person entitled to transfer *to any member* selected by the transferor; but save as aforesaid, and save as provided by sub-clause (6) or (8) of this clause, no share shall be transferred to a person who is not a member so long as any member or any person selected by the Directors as one whom it is desirable in the interests of the Company to admit to membership is willing to purchase the same at the fair value.

(2) Except where the transfer is made pursuant to sub-clause (6) or (8), the person proposing to transfer any shares (hereinafter called "the proposing transferor") shall give notice in writing (hereinafter called a "transfer notice") to the Company that he desires to transfer the same. Such notice shall specify the sum he fixes as the fair value, and shall constitute the company as his agent for the sale of the share to any member of the Company or person selected as aforesaid at the price so fixed, or, at the option of the purchaser at the fair value to be fixed by the auditor in accordance with these articles. A transfer notice may include several shares, and in such case shall operate as if it were a separate notice in respect of each. A transfer notice shall not be revocable except with the sanction of the Directors.

(3) If the Company shall, within the space of forty two days after being served with a transfer notice, find a member or person selected as aforesaid willing to purchase the share (hereinafter called "the purchasing member") and shall give notice thereof to the proposing transferor, he shall be bound, upon payment of the fair value, to transfer the share to the purchasing member.

(4) In case any difference arises between the proposing transferor and the purchasing member as to the fair value of a share, the auditor shall, on the application of either party, certify in writing the sum which, in his opinion, is the fair value; and such sum shall be deemed to be the fair value and in so certifying the auditor shall be considered

to be acting as an expert, and not as an arbitrator; and accordingly Ordinance No. 51 (Arbitration) shall not apply.

(6) If the Company shall not, within the space of forty two days after being served with a transfer notice, find a member or person selected as aforesaid willing to purchase the shares, and give notice in manner aforesaid, the proposing transferor shall at any time within two calendar months afterwards be at liberty, subject to sub-clause (9) to sell and transfer the shares or those not placed to any person and at any price.

(8) Any share may be transferred by a member to any child or other issue, son-in-law, daughter-in-law, father, mother, brother sister, nephew, niece, wife or husband of such member, and any share of a deceased member may be transferred by his executors or administrators to any child or other issue, son-in-law, daughter-in-law, father, mother, brother, sister, nephew, niece, widow or widower of such deceased member (to whom such deceased member may have specifically bequeathed the same) and shares standing in the name of the trustees of the Will of any deceased member may be transferred upon any change of trustees to the trustees for the time being of such will and the restrictions in sub-clause (1) shall not apply to any transfer authorised by this sub-clause.

(9) The Directors may refuse to register any transfer of a share (a) where the Company has a lien on the share; or (b) where the Directors are not of opinion that it is desirable to admit the proposed transferee to membership. But paragraph (b) of this sub-clause shall not apply where the proposed transferee is already a member nor to a transfer made pursuant to sub-clause (8)."

At the trial one expert witness was called on each side. The appellant's witness Mr. Dobson considered that the market value of a share was $125/-, and that about 20% should be deducted on account of the restriction on assignment.

Mr. Philip, who gave evidence for the Crown, said:

> "A purchaser would be more willing to buy a share for which there is a ready market. One discounts the value of a share for which there is no market. It is possible that the value of such a share might be discounted by 50% or 60%".

Mr. Philip appears to have valued the shares at $557.79 per share, but if these "A" shares were found not to be entitled to a share of surplus assets, then on a dividend basis he valued them at $375/- deducting nothing for lack of marketability, because, as he said, "I do not think that the marketability is very material. I consider them a long term investment".

The learned trial Judge touched upon this restriction of transfer, but he appears to have attached no weight to it and he accepted Mr. Philip's valuation of $375/- which I may here say is attached on other grounds besides the question of transferability.

It appears to me that although this Company is a very prosperous family concern, restriction on transferability must affect the value adversely.

In the *Crossman* case *(supra)* the Company was a family concern, Lord Hailsham in the course of his Judgment at p.43 said:

> "In the present case a share in such a Company as this, with an unrestricted right of transfer, would probably be worth twice as much as the £355 which is fixed by Finlay J."

Unfortunately, the case is only reported on the principle of valuation, the price the shares would fetch in the open market from a purchaser who would himself not be free to sell in the open market.

Lord Plender's estimate of that price was accepted by Finlay J. and by the majority of the House of Lords, but the report does not indicate the method by which Lord Plender arrived at the sum which should be deducted from the market price on account of the restriction on alienation in the hands of the hypothetical purchaser.

In the Irish case *Smyth v. Revenue Commissioners* (1931) Ir. R. 643 the accountant for the Revenue Commissioners valued the shares at 25/- and the Commissioners assessed them at 22/6, but I do not gather from the report that this reduction of 2/6 or 10% is wholly to be attributed to non-marketability.

Abatement cannot be determined on any arithmetical or geometrical progression based on the open market value of the shares. Such a method of valuation would result in absurdity because if the market value were sufficiently high the abatement might amount to 100%.

In my opinion there is no definite scale of abatement which can be rigidly applied to any shares. All the circumstances of the Company must be taken into consideration. Were there evidence before us of what the auditors regarded as a fair value, then we would have evidence of what the hypothetical purchaser could expect on a sale subject to the Company's restrictions and the difference between this figure and the open market value would give an indication of the amount to be allowed for the restriction on assignability, assuming the fair price to be less than the market price as this sum would represent the hypothetical purchaser's loss on a sale by him. I say that it would give an indication of the amount to be allowed but there may be other factors which might increase or reduce the amount of abatement.

All these factors are comprehensively referred to by Hanna J. in *Smyth's* case where he said:

> In my opinion, in estimating the price, every advantage and disadvantage to the company, and every benefit and clog attaching to the share, as well as the nature of the particular company, must be considered. According as the facts differ more weight will be given to one element than to another. You must consider the profit-earning capacity, the return for the purchaser's investment, the general solvency of the company, the extent of security in the shape of assets, the nature of the management, the objects of the company, its methods of business, the capital value of the assets of the company, the restrictions upon the transfer of the shares, and the amount of liabilities. On some of these elements persons accustomed to value can place a relevant figure, but the test for some of the others is merely general business experience. In my judgment, the profit-earning capacity of the share is the most important item, and would be most prominent in the mind of the purchaser in this case. When I say "profit-earning capacity" I mean profit-earning on a reasonable commercial basis for a company such as may be under consideration, not necessarily as appearing in the balance sheets, which may, for reasons of the proprietors, be prepared on a particular basis. But while that is in the foreground you must consider as a definite and well-marked background the capital value of the share. It may operate either to increase or decrease the price as the case may be".

No significance should be attached to the fact that it is a family company. The hypothetical value of the shares is the price they would fetch in the open market when the hypothetical purchaser might be an entire stranger.

The valuation of $375/- accepted by the learned trial Judge was arrived at without regard to the restrictions on marketability.

The fourth article provides that the rights attached to any class of share may be varied with the consent of a majority of the shareholders of that class. There is no evidence that it has been so much as suggested that the rights of "A" shareholders should be varied, but variation is a contingency which might affect a purchaser of Mrs. Hogg's shares who, unless he were already the holder of other "A" shares would be in a minority, could not defeat a bona fide exercise of the power conferred by the fourth article though he might regard the variation as detrimental.

I now turn to the financial position of the Singapore and General Investment Company Limited. On the 31st December, 1932, it had accumulated reserves amounting to $1,754,495. In 1933 the Company issued 5000 A shares of $100 each and the reserves stood at $1,331,546 at the end of that year. These reserves continued to accumulate and on 31st December, 1936, they amounted to $1,685,847, the Ordinary shares having been paid a dividend of 15% and the "A" shares a dividend of 5%.

The dispute in this case turns in the main on four questions, what, if any, rights have the "A" shareholders in the reserve; what dividend may the "A" shareholders reasonably expect; what would the value of the shares be in the open market, and when this third question is answered, what sum should be deducted from the open market value on account of the clog on assignability.

The Company is in a very sound financial position. Most of its investments are shares in Guthrie & Company Limited, a prosperous trading company whose $10/- Ordinary shares are admitted to be worth at least $22/- each and whose cumulative 6% $10/- Preference Shares are admitted to be worth at least $12/- each.

The Appellant's case is that the "A" shares have very small rights in the reserve (the winding up of the company being a contingency so remote that all parties agree it should be ignored as a possibility) and that as the policy of the company has been to accumulate all profits remaining after payment of 15% on the ordinary shares and 5% on the "A" shares, and as the "A" shares never have received more than 5%, 5% is the maximum dividend a

hypothetical purchaser would expect. On this basis, taking a 4% yield on his capital outlay, the hypothetical purchaser would be prepared to pay $125/- for each "A" share in the open market. From this sum Mr. Dobson (the accountant who gave evidence for the appellant) would deduct 20% for non-marketability and he assessed the shares at $100 each for Estate Duty purposes.

Article 96 reads as follows:—

> "The directors may, before recommending any dividend, set aside out of the profits of the Company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for meeting contingencies, or for equalizing dividends, or for any other purpose to which the profits of the Company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the Company or be invested in such investments, other than shares of the Company, as the directors may from time to time think fit."

The accumulation of reserves was mainly justified in the argument before us on the ground that the Company has a contingent liability to purchase the shares held in Guthrie & Company Limited by a person referred to as "the Director". Who that person is we were not informed, nor is it material. He does not appear to be a director of the Singapore & General Investment Company Limited.

The "Director's" shares in Guthrie & Company Limited were valued at $857,000 at the date of Mrs. Hogg's death and the appellent contended that if and when the contingent liability became an actual liability, these shares may have enhanced in value and also in number as it was possible that by that time Guthrie & Company Limited may have issued bonus shares.

It is said that the accumulation of $1,685,847 is far in excess of anything reasonably necessary to cover the contingent liability.

But profits may be placed to reserve for other purposes such as equalisation of dividends or with a view to issue bonus shares.

There is no suggestion that the directors have been acting or will act *mala fide* and in my opinion the policy of accumulating which has been acquiesced in by the "A" shareholders is one with which on the evidence the Court cannot interfere, and if the policy of accumulation is to be continued, I do not see how a larger rate of dividend than 5% is to be expected by a hypothetical purchaser, apart from dividends paid out of reserves which I shall consider later.

The learned trial Judge considered that the contingent liability has been amply provided for. I agree. But I think that when he says "the "A" shareholders have every right to expect a dividend of 15% on these shares," some qualification is necessary.

The "A" shareholders have a right to participate in a distribution of profits up to but not exceeding a dividend of 15% in respect of any year, if declared. Before such a dividend can be declared there must be profits available to pay it and unless the policy of placing a large proportion of the annual profits to reserve can be restrained, there will not necessarily be an available balance of profits from which more than 5% can be paid.

No evidence has been given as to the intention of the directors in making this large accumulation except to cover the contingent liability and after this liability as it existed on the 31st December, 1936, was covered, there was a surplus in reserve of $828,847.

Article 99A deals with the possible methods of dealing with reserve but before considering this Article it is desirable to ascertain what exactly is the interest of the "A" shareholders under Special Resolution 3 which reads:—

> "That the capital of the Company be increased to $1,000,000 by the creation of 5,000 new shares of $100 each to be called "A" shares and that the said shares shall carry (a) the right to participate in a distribution of profits up to but not exceeding a dividend of 15 per cent in respect of any year, if declared, after paying or providing for the payment of a dividend for such year on the Ordinary shares at the rate of 15 per cent but shall not carry any further right to participate in profits except to such extent (if any) as the Company in General Meeting may from time to time resolve; and (b) the right in a winding up to the whole of the surplus assets of the Company available for distribution amongst its members which remain after repaying the whole of the capital paid up on the Ordinary Shares."

It is admitted that there is no likelihood of a winding up of this prosperous company which would lead to a distribution among the "A" shareholders of the surplus assets so right (b) is of no practical importance.

It is clear from this resolution that the "A" shares get no dividend until the ordinaries have received 15%, but the resolution gives rise to two other considerations. The first is what dividend will the hypothetical purchaser expect from the words "the right to participate in a distribution of profits up to but not exceeding a dividend of 15% in respect of any year", coupled with the earnings of the Company, the mode of disposing of those earnings and the contingent liabilities of the Company? The "A" shareholders participate in a residue—in what is left of the profits after the Ordinary shareholders have received 15%. It is necessary first to consider the meaning of the phrase "the right to participate". The dictionary meaning of "participate" is "to have a share in a thing with a person" implying that more than one person participates. It was therefore argued that the first distribution of 15% having been paid to the Ordinary shareholders the right of the "A" shareholders is to participate with the ordinary shareholders in the second distribution, dollar for dollar, that is to say before the "A" shareholders can get 15% the ordinary shareholders must have got 30%: in other words the second distribution is to be divided between the two classes. This interpretation of the phrase has not been adopted by the Directors or by the Company during the three years prior to Mrs. Hogg's death in which the resolution was in force and it has been rejected by the learned trial Judge as strained.

Contemporary exposition is of weight if the document to be interpreted is ambiguous and if the interpretation has long been placed on the document or has received the tacit approval of the Legislature. This aid to interpretation—for it cannot be called a rule—is, in the case of statutes, only applied to old statutes. "I feel bound", said Lord Watson "to construe a recent statute according to its own terms when these are brought into controversy, and not according to the views which interested parties may have hitherto taken". *Clyde Navigation v. Laird* 8 App. Cas. 673. It seems to me Lord Watson's words are equally applicable to the construction of contracts. For contemporary exposition to be invoked in aid the document must be capable of two constructions. If it is not, there is no duty on a Court to perpetuate error. In a celebrated passage Lord Macnaghten dealt with long standing decisions on statutes. "I am sensible of the inconvenience of disturbing a course of practice which has continued unchallenged for such a length of time and which has been sanctioned by such high authority. But if it is really founded upon an erroneous construction of an Act of Parliament, there is no principle which precludes your Lordships from correcting the error. To hold that the matter is not open to review would be to give the effect of legislation to a decision contrary to the intention of the legislature, merely because it has happened, for some reason or other, to remain unchallenged for a certain length of time" *Hamilton v. Baker* 14 App. Cas. at 222. In *Attorney-General v. Mayor of Bristol,* Jac. W. at 321 Lord Eldon said "length of time is a very material consideration when the question is, what is the effect and true construction of the instrument? Is it according to the practice and enjoyment which has obtained for more than two centuries, or has that practice and enjoyment been a breach of trust? If it has, we must not scruple to distrust it". The way a family company has for three years construed its own articles or resolutions is of little or no value in deciding what those articles or resolutions mean. The rule for the construction of contracts is stated in 7 *Halsbury* 2nd Ed. para. 448.

"The language of the instrument is to be understood in its ordinary and natural meaning, notwithstanding the fact that such a construction may appear not to carry out the view which it may be supposed the parties intended to carry out". This is not a case of words being used in a special or technical sense nor is there anything in the context to shew that "participate" was not intended to be used in its ordinary sense.

The word is used in special resolution 2 in its ordinary sense "on a winding up of the Company none of such ordinary shares shall carry the right to participate in the surplus assets of the Company beyond the full amount paid up on each of such ordinary shares".

If it was not the intention that the "A" shares should participate with or share with the ordinaries in the second distribution, it would have been so easy to say that these shares shall carry the right to be paid, or to take in a distribution of profits but no such words are used.

Because no one in three years challenged the reading by the Directors or by General Meetings of the word "participate" as not meaning "share" is no bar to the hypothetical purchaser of an ordinary share claiming that he is entitled to participate with the "A" shareholders in the second distribution.

I therefore conclude that the correct reading of special resolution No. 3 is that on the second distribution the ordinary shares and the "A" shares take

pari passu, so before the "A" shareholders can get 15% the Company must have profits available for dividend sufficient to pay 22½% on the whole capital. Profits of $225,000, if available, would pay 22½%. The profits for 1930 and 1935 and 1936 were in excess of this sum while the average profits for the seven years 1930-1936 was about $222,240. This amount of profit, if available for dividend, would suffice to pay the ordinary shares 15% ($75,000) on the first distribution, leaving $147,240 for distribution between the ordinary shares and the "A" shares or 14.7% each provided none of the profits were placed in reserve. Three of the years over which I have taken the average were slump years.

But if a large proportion of the profits of each year is to be placed to reserve, there is no immediate prospect of the "A" shareholders receiving more than 5% on their shares.

The second consideration to which special resolution 3 gives rise is what is the meaning of "but shall not carry any further right to participate in profits except to such extent (if any) as the Company in General Meeting may from time to time resolve"?

As the dividend from profits of any year is expressly limited to a sum not exceeding 15% this "further right" which may be given by a General Meeting does not appear to be a right to a further dividend such as would make the dividend for that year exceed 15%. The directors cannot recommend a dividend on the "A" shares in excess of 15% in respect of any year and a General Meeting cannot declare or resolve that a larger dividend than 15% shall be paid to the "A" shareholders because Article 92 says "the Company in General Meeting may declare dividends, but no dividend shall exceed the amount recommended by the directors".

I therefore conclude that this "further right" which shall not exist unless given by a General Meeting is not a right to more than 15% in respect of any year.

What I think it does mean is that a General Meeting may authorise that the dividend paid to the "A" shareholders in respect of any former year may, if it has been less than 15%, be brought up to a sum not exceeding 15%.

It may also relate to a right to participate in profits which have been placed in reserve.

I think it must be taken that only so much of the accumulated profits in reserve as exceed the amount deemed necessary to cover the contingent liability to which I have already referred will be made available for distribution.

Article 99A is as follows:—

"99A(1) Any general meeting declaring a dividend may resolve that such dividend be paid wholly or in part by the distribution of specific assets, and in particular of paid up shares, debentures, or debenture stock of the Company, or paid up shares, debentures, or debenture stock of any other company, or in any one or more of such ways.

(2) Any general meeting may resolve that any moneys, investments, or other assets forming part of the undivided profits of the Company standing to the credit of the reserve fund or in the hands of the Company and available for dividend or any accretion to capital arising on sale or shown by a valuation or re-valuation of any property or assets of the Company be capitalised and distributed amongst the shareholders on the footing that they become entitled thereto as capital and that all or any part of such capitalised fund be applied on behalf of the shareholders in paying up in full any unissued shares of the Company and that such unissued shares so fully paid be distributed amongst the shareholders and shall be accepted by them in full satisfaction of their interest in the capitalised sum. The Directors shall give effect to any resolution under this article and for that purpose may settle any difficulty which may arise in regard to the distribution as they think expedient, and in particular may issue fractional certificates, and may fix the value for distribution of any specific assets, and may determine that cash payments shall be made to any members upon the footing of the value so fixed or that fractions of less value than $100 may be disregarded in order to adjust the rights of all parties, and may vest any such cash or specific assets in trustees upon such trusts for the persons entitled to any dividend or the capitalised sum as may seem expedient to the Directors. Where requisite, a proper contract shall be filed in accordance with

section 91 of the Ordinance and the Directors may appoint any person to sign such contract on behalf of the persons entitled to the dividend or capitalised fund and such appointment shall be effective."

I understood the Solicitor-General to admit that all the undistributed profits and all other surpluses referred to in Article 99A(2) could be capitalised by the issue to the ordinary shareholders of further shares of either class and that the "A" shareholders have no right to share in such an issue of bonus shares. This, I think, is correct.

But if the accumulated profits are to be distributed, the "A" shareholders cannot be entirely ignored.

Both parties are agreed that the most the "A" shareholders could expect from the reserve as at the date of Mrs. Hogg's death is 35% or 42½% on the capital of the shares, the percentage representing the sum necessary to bring up the dividends for each year to 15%. I think they have this right.

These percentages are arrived at in this way. The most an "A" shareholder could get in any one year is 15%. In 1933 2½% was paid while 5% was paid in each of the years 1934, 1935 and 1936. Treating 1933 (the year of issue of the "A" shares) as a half year, the "A" shareholders for that year got 5% less than the maximum while for each of the other three years they got 10% less. Therefore over the whole period each "A" shareholder got $35/- short of the maximum dividends he could have expected on each share. If 1933 is treated as a full year then over the period each "A" shareholder received $42½/- short of the maximum dividends. That is treating the dividends on "A" shares as cumulative. The articles do not say that they are cumulative, but I think that it is fair and reasonable that they should be so regarded because the distribution of the accumulated profits indicates that they might have been distributed in the years in which they were earned in which case the "A" shareholders could have been paid their full 15." The hypothetical purchaser might therefore reasonably consider that he would sometimes receive these arrears totalling $35/- or $42½/- in respect of each share purchased by him.

What value will he place on this expectation? The hypothetical purchaser who bought these shares on the day of Mrs. Hogg's death would have had a reasonable expectation of sometime receiving the sum which he might regard as being at that date owing to each holder of each "A" share.

But if the accumulations continue at the same rate, the annual dividend the hypothetical purchaser may receive is 5%, increasing his expectation from the reserve by $10/- per share per annum. In other words, he has some hope of receiving 15% per annum on his shares some time or other, namely, 5% in any one year and the remaining 10% at some uncertain future date.

I have pointed out that the reserve is far in excess of what is reasonably necessary to cover the contingent liability. Its distribution is therefore a matter which can reasonably be expected to take place sooner or later, and I think the "A" shares will have a claim to a share in that distribution, but that share will be such sum as is necessary to bring up past dividends to 15%.

If this were not so, the main purpose of special resolution 3, namely, that the ordinary shareholders are not to get more than 30% until the "A" shareholders get 15%, (on my interpretation of "participate in a dividend") could be defeated by the device of placing the bulk of profits in any one year to reserve, paying the "A" shareholders a token dividend and then distributing the accumulated profits among the ordinary shareholders.

I conclude therefore that the "A" shareholders have a right to have their dividends made up to 15%, if the accumulated profits are distributed. This right is, however, attended by two uncertainties. The date at which they will receive the arrears is unknown, and unforeseen events may cause such loss to the accumulated profits fund that payment cannot be made in full. Some values must be placed upon this right and taking all things into consideration, I think it may reasonably be valued at 3% per annum.

I regret that I am forced to hazard a valuation but as this expectation appears to have some real value and as there is no data from which the exact amount of that value can be deduced, I have taken 3% as a fair and reasonable percentage at which to assess it. The same difficulty often arises in the assessment of damages where no concrete reason can be given as to why the amount should not be reduced or increased by some "nicely calculated less or more."

I take it then that the hypothetical purchaser would count on a 5% dividend every year with reasonable expectation of sometime receiving the balance, and that expectation I venture to assess at 3% per annum, making an average expectation of 8% per annum by way of dividend.

On a 8% dividend basis for each "A" share a purchaser of an "A" share could pay $200 and I take that to be the open market value of the share.

I have not added anything for the solvency of the Company as the Company's solvency has already been taken into consideration as a basis of the expectation to receive the 5% and the 3%.

This open market value of $200 must now be reduced by reason of the restrictions on assignability. Mr. Dobson was of opinion that 20% should be taken off his valuation while Mr. Philip thought that as much as 50% or 60% might sometimes be allowed on some shares for non-marketability though he allowed nothing in this case.

Placing as I do a higher value on these shares than Mr. Dobson placed on them and considering that an allowance must be made for the restriction on assignability I reduce the $200 by 25% giving a value for Estate Duty purposes of $150 for each share.

Horne, J.—The principle upon which a valuation is to be made and the various Articles of Association have been dealt with fully in the judgment of the Chief Justice. The difficulty in the application of the principle lies in deciding what "rights" are attached to the "A" shares, and that decision depends mainly upon the meaning of Special Resolution 3. I agree that the subsequent acts of the directors in paying a dividend of five per cent to the "A" shares after paying a dividend of fifteen per cent to the ordinary shares would not preclude them from adopting the *pari passu* method of sharing the profits remaining after the ordinary shares have had their fifteen per cent. And I accept as a general aid to construction that "the language of the instrument is to be understood in the ordinary and natural meaning, notwithstanding the fact that such a construction may appear not to carry out the view which it may be supposed the parties intended to carry out". (7 Hals: 2nd Edn: para: 448). But as the instrument in question is a bargain between shareholders and a company, I think, it is always legitimate to look at all the co-existing circumstances in order to apply the language and so to construe the contract", *Lewis v. Nicholson,* 18 Q.B. 503 at p. 510.

This Special Resolution was confirmed on the 27th July 1933. On the same day Special Resolution 1 (a) made the additions to Article 17 restricting the right of transfer, Special Resolution 1 (b) altered Article 33 and thus permitted the creation of classes of shares. Special Resolution 1 (c) introduced a new Article 99A permitting a general meeting to capitalise profits and distribute them on the footing that shareholders became entitled thereto as capital; Special Resolution 2 renamed or classified the existing shares "Ordinary" shares and dealt with the rights of those shares on a winding-up; and Special Resolution 3 created the new "A" shares and attempted to declare the dividend rights of both Ordinary and "A" shares. Up to this day the 27th July 1933 the capital was $500,000 in 5000 shares of $100 each, of which 4997 were issued and 4995 were held by Lady Anderson. The remaining two issued shares being held by the two directors, who were her nominees. The issued shares had for some time past received an annual dividend of fifteen per cent and the remainder of the profits had been accumulated and were then invested in securities. On the 27th July 1933 in pursuance of the powers taken under Article 99A the company capitalized $500,000 of its accumulated profits and an agreement was executed and registered and the "A" shares were issued to Lady Anderson practically the sole shareholder and to members of her family nominated by her. On the same date a dividend of five per cent was declared on the "A" shares.

Such are the co-existing circumstances, which I have in mind in dealing with the meaning of Special Resolution 3; and the outstanding fact is the intention of this resolution to preserve the dividend of 15% regularly paid to the original or ordinary shares. Therefore these shares are given a dividend of a specified rate in preference to the other class. The 'Ordinary' shares are to be paid this rate before the other class get anything at all and *prima facie* such a dividend would be cumulative.

All that is said about the Ordinary shares are the words—"after paying or providing for a dividend for such year on the ordinary shares at the rate of 15 per cent". There are no words used in relation to such dividend which would show that the dividend is to come out of the profits of the year. Usually shares which confer a fixed rate of dividend will *prima facie* confer no further right to participate in profits, (*Will v. United Lankat Co.* 1914 A.C. 11), and although neither the word "fixed" nor the word "cumulative" are used in reference to the ordinary dividend, the fact that there can be no distribution of profits to the "A" shares until "After" a dividend of 15 per cent is provided for the ordinary shares does plainly make the ordinary dividend a fixed dividend in the first place and also a cumulative dividend in contradistinction to the "A" share dividend, which is a specified but limited dividend and their

deferred right to this dividend is expressly made non-cumulative by the words "but shall not carry any further right to participate in profits". The words "if declared" seem of no value for no dividend can be claimed until it is declared.

It must however be taken into account that the original shares are not classified as Preference shares but as Ordinary shares. And their further right, the right of any corporator to share in further profits, after the right of "A" shares to dividend has been met, is, on the construction of the Resolution, not interfered with. But, in my opinion, the right of the "A" shares does not fall to be considered until the *Ordinary* shares have had what is in effect a fixed and cumulative dividend of 15 per cent. That, in my opinion, is what they are entitled to on what has been termed the first distribution.

The company has always been able to pay and has paid such dividend year by year on the Ordinary shares, therefore there is no reason, apart from policy, for restricting the "A" shares non-cumulative dividend below 15 per cent.

The words describing the right of the "A" shares are as follows:—

> (a) "the right to participate in a distribution of profits up to but not exceeding 15 per cent in respect of any year, if declared,..... but shall not carry any further right to participate in profits".

It has been submitted that these words make the dividend to the "A" shares a pure act of grace on the part of the directors who, according to the argument, may pay or not; and, further if nothing or some small dividend is paid, may, without let or hindrance carry forward undistributed profits and subsequently distribute the same solely to the Ordinary shareholders. If that were really the case, it would be tantamount to saying that a company can capitalise accumulated profits of $500,000 and that the capital, when it passes on death, is worth nothing, or nothing more than the capital value of the dividend actually being paid at the time of the death.

I accept however that the company or the directors may accumulate profits, but I question the view that the company can pay the whole of the profits accumulated in this case to the Ordinary shareholders after giving the "A" shares a 5 per cent dividend and after giving in the year the accumulations are distributed, a 15 per cent dividend to the "A" shares.

The "right" to a dividend limited in amount cannot be, in my view, a mere discretion. It is a "right" pertaining to a particular class of shares, the "A" shares; and that right has to be satisfied before any further right of the Ordinary shares falls to be dealt with. Year by year, it would be difficult for the "A" shareholder to claim any higher dividend than that declared. But if it were proposed after the Ordinary shares had had their 15% to pay 5% to the "A" shares and then distribute a further dividend to the Ordinary shares, a conflict between the interest of the two classes would arise, and without any allegation of *mala fides* on the part of the directors or the majority of the shareholders, an "A" shareholder, objecting to such a proposal, could come to Court for a declaration as to the disputed rights of the two classes.

The words of the resolution describing the "right" of the "A" shares are, admittedly unusual, but they do nothing more than to restrict, in the first place, the dividend to 15%. It is a "fixed" dividend in that it cannot be exceeded except by a resolution in General Meeting, and the wording which permits less than the limited amount to be paid and the words which show it to be non-cumulative are introduced mainly to make the dividend dependent upon the fortunes of the Company.

The "A" shares therefore come in after the Ordinary shares, and the Ordinary shares further right to participate does not arise until a dividend of 15% has been paid on "A" shares; and in that further participation the "A" shares then have no part unless the Company so resolves. One cannot overlook the fact that this construction has been acted upon although the fact that it has been acted upon does not of itself show that such construction is legally correct.

The position at the date of death was that the Ordinary shares have always had their 15 per cent and no more and the "A" shares have had 5 per cent and the accumulated profits are of considerable value. If one takes the definition of profits given by Lord Shand in *City of Glasgow Bank v. Mackinnon* quoted in a note on p. 75 of Stiebel 3rd Edition Vol: 1. which is as follows:—

> "In order to acertain the profits earned and divisible at any given time the balance sheet must contain a fair statement of the liabilities of the company including its paid-up capital, and on the other hand a fair or more properly a *bona fide* valuation of assets, the balance if in favour of the company being profits"—then at the date of

death the revalued assets (p. 88 Record) being $5,580,675.68:

The paid-up capital	999,700.
The contingent liability for the purchase of Guthrie & Co., shares & $857,000 included in the Reserve	1,000,000.
Sundry creditors	811.35
Reserve account	14,643.70
Directors' fees	3,600.00
	2,118,755.05

5,580,675.68.
2,118,755.05

3,461,920.63

Then the undivided profits are $3,461,920.63 of course these profits are not altogether in a liquid form being represented by an increased but bona fide valuation of the Guthrie shares and by sundry investments —very safe investments apparently—of $1,129,031.33 at market value. The latter appear to be liquid. But liquidity of assets is not necessary for a further bonus distribution, it therefore falls to be considered whether "A" shares would not be entitled to benefit in any such distribution, directly or indirectly.

It is conceded by the Crown that any distribution under Article 99A will be on the basis of the dividend rights of the two classes of shares. Accordingly, as in my view of Special Resolution 3, no right to participate by way of dividend arises in the Ordinary shares, (if they have had their 15 per cent cumulative dividend) until the "A" shares have had their 15 per cent dividend, the mere fact that the "A" shares have only been paid a dividend for a period of years of 5 per cent does not prevent the "A" shares from claiming up to and not exceeding 15 per cent before the Ordinary shares receive anything further. Because a "right" to receive up to but not exceeding 15 per cent is a right to receive that amount if it is there. If it were a right to a mere discretionary dividend it would be quite easy to say for example "a right to receive such dividend as the directors may declare on such shares in any year".

We are not limited to looking at the actual dividend paid on these shares in order to arrive at the valuation. We are not concerned with the internal management: the paying of a dividend less than 15 per cent to the "A" shares and the accumulation of reserves. The question is how far can these reserves be considered in relation to the value of the "A" shares. It is strongly submitted upon the authority of *Burland v. Earle*, 1902 A.C. 83, that the company under Article 99A can at any time capitalize the whole of them and distribute them to the Ordinary shareholders. It is however conceded by both parties that the rights in the capitalized fund will be on the basis of the dividend rights of each class of shares. Accordingly, as in my opinion, no further right of the Ordinary shares to dividend arises until the 15 per cent dividend has been paid to the "A" shares the company cannot distribute a capitalized fund until they can show that there has been no abuse of the power of the directors in restricting the dividend of the "A" shares to less than their maximum. There has obviously been ample to pay 15% to each class year by year. Even on the other construction of the resolution there has been ample profits earned annually to pay 30% to the Ordinary and 15% to the "A" shares. Although *Burland v. Earle* is a strong authority in the appellant's favour I would nevertheless refer to a passage in the judgment at p. 97 where Lord Davey says: "If it appeared that under the guise of investing undivided profits or the reserve fund, the directors were embarking the moneys of the company in speculative transactions, or otherwise abusing the powers vested in them for management of the company's business different considerations would of course arise". In the circumstances disclosed in this case and on the highly solvent position of the company and the amount of its annual profits, the placing to reserve of such large amount appears an abuse of power.

Especially if it is to result in a distribution, on a basis of dividend right, to the Ordinary shareholders before that right, (i.e. to more than their 15 per cent) can be said to arise. Directors cannot act as they please, they must exercise their powers so as not to give themselves an advantage and so as not to favour a particular class of shareholders. *Alexander v. Automatic Telephone Co.* (1900) 2 Ch. 56 at pp. 67 & 72, *Kerry v. Maori Dream Gold Mines Ltd.* 14 T.L.R. 402. The distribution of a capitalized fund in the manner which is suggested as possible would go beyond being a matter of internal management and would raise a question of the rights of classes which would be subject to the jurisdiction of the Court. Moreover, although the voting power in the Company is in another company, which holds all the Ordinary shares and 1668 out of 5000 of the "A" shares, and a resolution to the effect suggested is,

apart from the question of conflict of class rights, possible; there is authority for saying that "while usually a holder of shares or debentures may vote as his interest directs he is subject to the further principle that where his vote is conferred upon him as a member of a class he must conform to the interest of the class itself when seeking to exercise the power conferred on him in his capacity of being a member".

British America Nickel Corporation v. M. J. O'Brien, 1927 A.C. 363 at p. 373. It would not be difficult, I think, if the suggested distribution were persisted in to show, to use the words of Lord Macnaghten in *Dominion Cotton Mills v. Amyot,* 1912 A.C. 546 at pp. 551, 552, "that the majority have abused their powers and are depriving the minority of their rights".

I therefore find it difficult to avoid the conclusion that at some time or other whether by way of dividend year by year or whether by way of a bonus distribution under the Article 99A the "A" shares will be able to obtain the dividend limited to 15 per cent per annum and think that the learned trial Judge was right in saying that a dividend of 15 per cent was to be expected.

There are however certain depreciating factors which have to be considered. Firstly there is the control of the company which is clearly in United Investments Ltd. Certainly a minority "A" shareholder of the company can not influence policy, but it does not mean that he can be deprived eventually of all interest in the accumulations. It is a delaying factor which must depreciate the value. Certainly the rights of the "A" shares could be varied by a majority, but this is only a possibility, and there is no reason to expect those rights to be varied. Then there are the restrictions on transfer under Article 17. *Smythe's* case and *Paulin's* case show that a share in a private company with restrictions of this character are valued upon a basis which will return a yield to the hypothetical purchaser of 10 to 12½ per cent per annum. Even Mr. Philip, having fixed $375 as the value on a 4 per cent yield, in cross-examination expressed the view that such a share might be discounted 50 to 60 per cent on account of lack of transferability, but later expressed the view that a purchaser would look upon the shares as a long term investment and so appeared to discount entirely the matter of tranferability. Mr. Dobson, on the other hand, considered a fifth of his value viz: $125 should be allowed, that is only an allowance of 20%. This factor cannot be discounted entirely. The "fair value" ascertained under Article 17 on a transfer between members can, however, be left out of account as was done in *Paulin's* case.

On Mr. Dobson's calculations the value is first of all $125 reduced to $100 by this transferability factor; but his calculations are all based on the assumption that the shares are entitled to no more than 5% and with no expectation of a higher dividend. The learned trial Judge appears to reject the evidence of Mr. Dobson as to a reduction of one fifth (or 20 per cent) of his value for want of marketability, and also Mr. Phillip's statement in cross-examination that 50 to 60 per cent should be allowed for this depreciating factor. He appears to base his value upon Mr. Philip's later statement in re-examination "I do not think the marketability is very material. I consider them ("A" shares) a long term investment". The learned Judge also took the view that 12½ per cent yield in *Paulin's* case was not a guide to him because, in his opinion, the restrictions on transfer were not so onerous as they were in *Paulin's* case. In my opinion, the restrictions created by Article 17 are, however, very little different in essentials from those in *Paulin's* case. But the company is not a trading company, though of its assets of $5,380,675, $2,455,000 are in Guthrie's, which, besides being a general trading company, is also to some extent a holding company. In short then the learned Judge has accepted Mr. Philip's view that a hypothetical purchaser would with regard to these shares be prepared to pay a price which on the basis of a 15% dividend would yield him a return of 4% on the price paid. But, in my opinion, this leaves out of account all the depreciatory factors. I can see no actual or possible benefits likely to accrue to these shares apart from the payment to them of a dividend of 15% and that may be delayed until distribution of the accumulated profits takes place. The 15 per cent which has been used as a basis for calculation by Mr. Philip must, I think, be reduced to 12 per cent by reason of the delaying factor. That would give a value of $300 on the 4 per cent yield taken by Mr. Philip. Then the lack of transferability falls to be considered. The expert witnesses differ considerably on this point. Even if these shares are to be considered as long term investment the local rate on mortgages is seven per cent without any restriction on transfer at all. The four per cent basis is therefore only theoretically applicable, and a hypothetical purchaser faced with all the depreciatory factors would, I think, be inclined to discount the theoretical value of $300 by as much as fifty per cent. Accordingly I would value the shares at $150. each.

Mills, J.—Mrs. Hogg died on the 15th November, 1936. Her estate included 833 "A" shares of $100 each in the Singapore and General Investment Company (hereinafter called "the company").

These shares had to be valued under Section 15 of the Estate Duty Ordinance (Cap. 227).

The Commissoner of Estate Duties valued them at $959 each. Her executors, being dissatisfied with this figure, petitioned the Court to determine the valuation..

On the 8th July, 1938, the learned trial judge valued the shares at $375 each.

The executors appeal to the Court of Appeal.

On the 15th November, 1936, the authorized capital of the Company was $1,000,000 and the issued capital $999,700, made up of 4,997 ordinary shares of $100 each and 5,000 "A" shares of $100 each: the deceased owned a holding of $83,300, i.e. 833 shares of $100 each.

On the 31st December, 1936, the assets of the Company amounted to $2,685,832.75, of which $1,498,500.00 represented the value of 124,900 ordinary shares of $10 each and 125,000 6% cumulative preference shares of $10 each in Guthrie and Company, Limited.

It is to be noted,

that two holding companies (i.e. the Company and United Investments Malaya Ltd) control each other by virtue of their investment in each other's share capital;

that the company controls Guthrie and Company, Limited; that if Guthrie and Co. Ltd., a trading concern, fell on evil days, the assets of the company would be materially affected;

that Guthrie and Co. Ltd., have at times made very serious losses; and

that as the deceased held only one-sixth of the "A" shares, she could not have successfully opposed a variation of the rights appertaining to those shares if all the other "A" shareholders consented; and that the shares in the company are subject to a restriction on transfer.

Under Section 15 (i) of the Ordinance the value of the shares shall be estimated to be the price which in the opinion of the Commissioner such property would fetch if sold in the open market at the time of the death of the deceased.

Since the shares are subject to a restriction on transfer, this market must be a hypothetical one, and the purchasers must be hypothetical persons.

These conditions surround the problem with an atmosphere of artificiality.

The Court must attempt to dispel this atmosphere, to "get into the skin" of a prospective purchaser, to ascertain and weigh the reasons by which he would be actuated before making his bid.

I take it that the Court will assume him to be the "ordinary reasonable man", and therefore to possess ordinary reasonable qualities: included among these qualities will be ordinary reasonable prudence and capacity for careful forethought. As a man of ordinary reasonable prudence, the prospective purchaser before buying "a bundle of rights and liabilities" will take legal advice, and before buying shares in a private company whose financial circumstances are somewhat involved, he will take financial advice. Certain it is that the Court must consider the evidence of the financial experts: in my opinion it necessarily follows that the prospective purchaser must be presumed to have consulted them too.

What type of man will be sure to exercise careful forethought? Surely, the incurable sufferer making an investment which will provide the sole maintenance for his widow and children. When one comes down to realities, the task before the Court, as I see the position, is to decide what bid would be made by an incurable sufferer after consulting Messrs. O'Connor and Worley on the legal position and Messrs. Dobson and Philip on the financial position.

Learned Counsel examined every aspect of the case with meticulous care, and their labours have greatly simplified the case before this Court.

The learned Solicitor-General eventually stated to us that there were only two issues on which he was at variance with the appellants:

(1) the priority and the proportion in which the yearly dividend should be distributed to the ordinary and "A" shareholders under special Resolution 3

(2) (a) whether the Judge rightly found that a prospective purchaser could reasonably expect to get a dividend of not less than 15% per annum in future.

(b) whether the Judge made a proper allowance for the various factors which would tend to raise or lower the value of the shares.

As to (1).

This is purely a matter of law.

(The appropriate quotations from the Memorandum and Articles of Association and the Special Resolutions have been set out in the judgment of the learned Chief Justice and I need not re-state them.)

In the view which I take of the present case, it is not necessary to decide this point of law.

As to 2 (a).

The learned Judge uses the expressions
"have a right to 15%";
"have every right to expect a dividend of 15%";
"the right to a dividend of 15%";
"the prospect of the shares earning 15%".

Counsel for the appellant interprets the Judge to mean that as a matter of law he holds that the "A" shareholders are entitled to a dividend of 15% per annum.

The Solicitor-General interprets the Judge to mean that as a matter of fact he finds that a prospective purchaser has good ground for thinking that in future he is reasonably certain to receive a dividend of 15% per annum.

I must confess I am in great doubt as to the exact significance which ought to be attached to the learned Judge's words: I am inclined to think that the learned Judge meant this:—

> "I find as a matter of fact that a prospective purchaser had good ground for thinking that in future the profits will be sufficient to pay 15% per annum.
>
> And I hold as a matter of law that when they are sufficient, "A" shareholders are entitled to receive a dividend of 15% per annum".

I regret that I am compelled to dissent from the view that the "A" shareholders are entitled to receive a dividend of 15% per annum, whether conditionally or unconditionally.

> The right is set out in Special Resolution 3:
>
> "the right to participate in a distribution of profits up to but not exceeding a dividend of 15% in respect of any year, if declared":

in my opinion this clause must be interpreted to mean that the shareholders have the right to participate in a distribution of profits which will give them a dividend of anything more than zero and not more than 15% in respect of any year, if declared:
for instance, the dividend may be ¼%, 4%, 8%, 12% or any other figure up to 15%, but must not be more than 15%. As to the amount of the dividend which may be expected with reasonable certainty, the expert witnesses differ.

Mr. Dobson says "Expectation of income not much if at all in excess of 5%".

Eventually, however, he decided that nothing more than 5% could be expected, since he valued the shares on a 4% basis as worth $125.

Apparently he based the expectation of 5% on the ground that 2½% was paid for 1933, and 5% for 1934, 1935, and 1936.

Though he states "It would seem that rate would be increased in the near future", yet I conclude that he regarded this as a mere possibility or a remote probability, and not as a factor which would weigh with a purchaser.

So too, he takes into consideration, but attached no weight to, the possibility that the dividend will be increased if the reserves are sufficient to discharge the contingent liability and the expectation of profits remains the same.

Mr. Philip lays a number of alternatives before the Court.

First, he says that he considers the basis of the Commissioner's valuation, i.e. valuation of surplus assets, to be correct: this basis has been abandoned by the Solicitor-General.

He appears at times to have considered that "A" shareholders were entitled to a dividend of not less than 15% per annum, for he states

"I assumed that the rights of the two classes of shareholders would be respected, i.e. Ordinary shares entitled to preferential dividend of 15%. *A shares* 15% in any year if declared after providing for 15% on ordinary shares"

and again

"The lowest value I could put on A shares on dividend right alone would be $375 per share"

and again

"In 1934–5, and–6 they got 5% each year. There was a balance of 10% more which they should have got. They might have got more by a resolution.

Without that they should have got 42½% more if they received in full for 1933, but if only for half a year then 35% more".

When asked whether a purchaser going on the articles would reasonably expect to get more than 15%, he replies "Yes, but only by the grace of the Company".

He thinks that if the contingent liability were adequately provided for, the only effect on the "A" shareholders "would be the expectation of increased dividends, i.e. up to 15% unless the Company decided to give more".

He arrived at a valuation of $1,015 a share on the same basis as the Commissioner's but without making a deduction for winding-up expenses: however, he did not ask the Court to accept that valuation: nor did he ask the Court to accept a valuation of $878 arrived at by a different method: he favoured a valuation of $557, arrived at on the basis that the surplus assets were distributed equally: this, assuming a 15% dividend, would give a return of 2.7%.

The learned Judge rejected the valuation favoured by Mr. Philip; as I understand it, he found that the profits would with reasonable certainty be sufficient to provide for a dividend of 15% for the "A" shareholders, and, holding that such shareholders were entitled under such circumstances to that dividend, valued the shares at $375 each, on a 4% basis: if the interest return were the only consideration, he says, he would have taken a 5% basis, but he reduced this to 4% because he thought that a purchaser would take into consideration the other actual and possible benefits likely to accrue to "A" shareholders.

The problem before the Court is to decide what conclusion our prospective purchaser would have come to after hearing the opinions of Messrs. Dobson and Philip.

Their evidence is on record, and as no question of credibility is here involved, the Court of Appeal is in as favourable position as the Judge when this question of fact has to be decided; if we are satisfied that the Judge is wrong, it is our duty to vary his finding of fact.

Mr. Dobson's views are definite and easy to follow: his conclusion is that nothing more than 5% can with reasonable certainty be expected.

Mr. Philip's views are indefinite and difficult to follow.

He nowhere states explicitly what percentage the purchaser may reasonably expect to receive.

To my mind he is unconvincing because

(a) his view that valuation should proceed on the basis that surplus assets would be distributed equally, is unsound; the learned Judge rejected it:

(b) his view that there is a "dividend right" to 15% is unsound; the Solicitor-General agrees that there is no such right:

(c) his view that a purchaser would reasonably expect to get more than 15% per annum, can scarcely be taken seriously; nobody argues in favour of such an expectation.

Giving my best consideration to Mr. Philip's evidence, I am driven to the conclusion that he is unable to say what percentage a purchaser could expect with reasonable certainty.

That being so, there is no opinion to be weighed against the opinion of Mr. Dobson that not more than 5% can be expected with reasonable certainty.

Therefore the prospective purchaser would accept Mr. Dobson's opinion.

Consequently the Court must accept Mr. Dobson's opinion.

There are three matters on which I feel very strongly that the learned Judge's conclusions cannot be justified.

In the first place, he impliedly presumes that the company's profits (largely dependent on the success of a trading concern) will always be such that a dividend of 15% per annum can be paid:
there is no expert evidence in favour of this presumption, and I do not consider that the Court is justified in making this presumption merely from an inspection of past balance sheets: on the contrary, there is evidence that Guthrie and Co. Ltd., have at times made very serious losses.

Mr. Philip considers this "a long term" investment:
surely "a long term" must cover a period of at least 20 years: and is it not fantastic for the Court to prophesy whether Guthrie and Co. Ltd., will be making a profit or a loss in 20 years' time?

Their working profit or loss might be affected by a hundred conflicting factors: who can calculate

the effect of a European conflagration? who can estimate the result of a Chinese boycott of Japanese goods? who can gauge the trade dislocation caused by an American import-duty?

Our prospective purchaser might well ponder over the vicissitudes wrought by the whirligig of time in the fortunes of a local trading concern whose finances have recently been reconstructed: in 1929 the Preference shares of $100 stood at $128 (lowest) and the ordinary shares of $10 at $19 (lowest); with an issued capital of $2,000,000, there were reserves of $400,000: in 1936, the position was that no dividend had been paid since 1930; the Preference shares stood at $50 (lowest) and the ordinary shares at $1.35 (lowest); in the period 1932-1936, losses of $621,598 were incurred; the reserves had disappeared.

In the second place, the learned Judge finds as a fact that a prospective purchaser will anticipate that the directors will, with reasonable certainty, recommend, and the company will, with reasonable certainty, declare a dividend of not less than 15% every year:

> there is no evidence in my opinion, to justify such a finding.

If it is assumed that in every year some of the profits are placed to reserve, can the "A" shareholders expect with reasonable certainty to participate in those reserves?

The Solicitor-General conceded that they cannot.

In my opinion he was right.

There are 2 alternatives:—

1. At some future point of time the company has the right to pay to the "A" shareholders a dividend of 15% in a particular year, and then distribute the rest of the reserves to the ordinary shareholders:
   but this point of time may be 5 or 10 or 20 years hence:
   Mr. Dobson, in effect, expressed the view that this possibility of 15% in one particular year at some future date, would not cause a purchaser to attach any higher value to the share:
   Mr. Philip did not express an opinion on this point:
   consequently there is no evidence to modify Mr. Dobson's view:
   therefore, in my opinion, the Court must adopt Mr. Dobson's view.

2. The reserves may be accumulated indefinitely until the point is reached when a satisfactory dividend can be paid from interest on investments, and it is immaterial whether the Company makes a working profit or not.
   By article 96, the directors may set aside such sums as they think proper as a reserve or reserves, which shall, at the discretion of the directors be applicable for any other purpose to which the profits of the Company may be properly applied.

   The Court has no jurisdiction to say what reserve fund may be "properly" required; what portion of the profits should be retained, is entirely a question of internal management which the shareholders must decide for themselves, and the Court has no jurisdiction to control or review their decision (*Burland v. Earle* (1902) A.C. at p. 95).

   In practice, one finds many examples of companies which accumulate large reserves: for instance, a local tin-smelting company of the highest standing with a paid-up capital of $9,000,000 had investments of over thirteen million dollars in September, 1936: in 1935 a group of 25 insurance companies paid 86% of their dividends from interest on investments: a tin-mining company has reserves amounting to more than three times the paid-up capital: a Hongkong bank has reserves amounting to over five times the paid-up capital; a motor manufacturing company has reserves amounting to over ten times the paid-up capital; and so on.

In the third place, the learned judge holds as a matter of law that, if the profits are sufficient, the "A" shareholders have a right to a dividend of not less than 15% per annum:

> in my respectful opinion, this decision is not correct: the constitution of the Company does not give such a right.

My conclusion is that the Court must accept Mr. Dobson's expert opinion that a potential purchaser

will take the view that he cannot with reasonable certainty expect more than 5% per annum as dividend.

On this basis, the shares will be worth $125 each.

As to the issue 2 (b).

The factors, other than the anticipated income, which would influence a purchaser, are treated by Mr. Dobson as follows:—

(a) Variation in amount of dividend:
he thinks there is a tendency for the profits available for dividend to increase:

(b) Security of the capital:
he thinks there are features which might impair the security of an "A" shareholder's capital:

(c) Factors affecting the capital value:
he thinks that there are no prospects of appreciation, but some danger of depreciation:

(d) Restriction on the right to transfer:
he thinks that this would depreciate the the value of the shares.

He sets the favourable factor (a) off against the unfavourable factors (b) (c) and (d): and without attempting to represent the weight of these factors by a mathematical figure, he reaches the conclusion that the nett result of these factors will be to reduce the value of the shares from $125 to $100 each.

Mr. Philip's views on these factors are as follows:—
as to (a): as already stated, he thinks there will be no reduction of the 15% dividend:
as to (b): I understand him to express the opinion that the security will not be impaired:
as to (c): he assumes that the rights of the "A" shareholders will not be devalued.
as to (d): though he states a general rule "One discounts the value of a share for which there is no market. It is possible that the value of such a share might be discounted by 50% or 60%, yet he thinks that rule is not applicable in the present case, "In the case of these particular shares I do not think that the marketability is very material. I consider them a long term investment."

The learned Judge states that all the rights and liabilities incident to the shares must be taken into consideration: he regards "the right to a dividend of 15%" as "clearly the most important of the rights", and adds "but all the other elements must be taken into consideration."

He then sets out those elements

(a) restriction on alienation

(b) right to purchase the shares of other members at a fair value

(c) the prospective right on a winding up

(d) the amount of the assets

(e) the possibility of the "A" shares receiving a dividend in excess of 15%

(f) the possibility of the "A" shareholders participating in a further distribution of shares.

His conclusion is that, if the interest return were the only factor to be considered, he would estimate the value of the shares on a 5% basis: but he thinks that a purchaser would take into consideration the other actual and possible benefits likely to accrue to an "A" shareholder, and he accordingly accepts the lowest of Mr. Philip's valuations and values the shares on a 4% basis at $375 per share.

If I understand him correctly, he takes the view that if dividend were the only consideration, he would value the shares at three times the par value because the anticipated dividend of 15% is three times as large as the "basis" of 5%: i.e. he would value the shares on dividend alone at $300 a share: but he regards the "other elements" as raising the value of the shares from $300 to $375.

In taking this view

(a) he rejects the "basis" of 4% accepted by both Mr. Dobson and Mr. Philip

(b) he rejects the opinion of Mr. Dobson that the other factors would reduce the value of the shares

(c) he rejects the opinion of Mr. Philip that the other factors deserve no weight.

In my respectful opinion the learned Judge was not justified in rejecting the basis of 4% accepted by both expert witnesses: and was not justified in finding that the other factors would increase the value of the shares, for neither of the expert witnesses took this view.

In my opinion the Court must accept the 4% basis.

As regards the effect of the other factors, there is a clear conflict of opinion between Mr. Dobson who thinks that they will reduce the value of the share from $125 to $100, and Mr. Philip who thinks that they will not reduce the value of the shares at all.

The expert witnesses do not give sufficient reasons to enable the purchaser to arrive at any particular figure for the amount (if any) by which his provisional valuation of the shares should be affected by reason of each of the factors (a) (b) (c) and (d).

May be nobody could place a relevant figure on these factors: maybe the test is "merely general business experience".

But the purchaser must arrive at some conclusion after hearing the conflicting opinions of Messrs. Dobson and Philip, and it is the duty of the Court to ascertain what that conclusion is.

It is a most difficult duty to perform:

> after giving much consideration to the point, I think that our prospective purchaser would err on the side of caution; that he would not feel confident as to the correctness of Mr. Philip's view that it was reasonably certain that his capital would not depreciate in value; that he would accept Mr. Dobson's view that it would probably depreciate in value; that he would deduct the $25 from the $125 as advised by Mr. Dobson.
>
> My conclusion is that the prospective purchaser would not offer more than $100 for this share.

In fine, I estimate the value of these shares under Section 16(i) of the Estate Duty Ordinance at $100 a share.

Value of shares reduced.

END OF STRAITS SETTLEMENTS OFFICIAL REPORTS.